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No. 98-589

In The

Supreme Court of the United States

October Term, 1998

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,

Petitioners,

v.

PAUL CASAROTTO and PAMELA CASAROTTO,

Respondents.

On Petition For A Writ Of Certiorari
To The Supreme Court Of Montana

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether a state court, applying traditional conflict-of-law principles, may enforce a state law requiring disclosure of an arbitration clause in a contract, when the contract specifies that state law shall govern the contract and when the application of the state law would not undermine the goals and policies of the Federal Arbitration Act, 9 U.S.C. § 1, *et seq.*

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Respondents Paul and Pamela Casarotto respectfully request that this Court should deny the Petition for Writ of Certiorari seeking review of the Montana Supreme Court's judgment in this case. That opinion is now reported at 901 P.2d 596 (1995).

STATEMENT OF THE CASE

A. Factual Background

Respondent Paul Casarotto entered into a Franchise Agreement with Petitioner Doctor's Associates, Inc. ("DAI") allowing him to open a Subway Sandwich Shop in Great Falls, Montana. Pet. App. 12a-13a. DAI, then a Connecticut corporation, franchises Subway Sandwich Shops. Pet. App. 12a. Petitioner Nick Lombardi ("Lombardi") is an independent contractor who serves as DAI's Montana Development Agent. Pet. App. 12a.[1]

Page nine of DAI's standard Franchise Agreement, which was entered by Paul Casarotto and DAI, contains an arbitration clause which calls for arbitration of claims

[1] Even though Mr. Lombardi was not a signatory to the franchise agreement, he appears to claim that he is also entitled to arbitration of the Casarottos' claims against him, based on a franchise agreement to which he is not a party. Although DAI refers to Lombardi as its development agent, DAI has been equivocal regarding Lombardi's agency status in the proceedings below. Pet. 4; Appellees' Response Brief at 7-8, 21-22, 26, *Casarotto v. Lombardi*, 886 P.2d 931 (Mont. 1994). The Montana court did not reach the issue as to whether the arbitration clause in DAI's franchise agreement would extend to Casarottos' claims against Lombardi.

in Bridgeport, Connecticut. Pet. App. 2a. The full text of the arbitration clause is set forth at Pet. App. 13a-14a. The Franchise Agreement calls for the application of state law, and designated Connecticut law. Pet. App. 15a.

A dispute arose when Lombardi and DAI awarded Casarottos' preferred location in Great Falls to another franchisee, after agreeing to reserve that site for Casarottos, according to the Complaint. Pet. App. 13a. The Complaint alleges the following: Lombardi informed Casarottos that their preferred location in Great Falls was not yet available. Pet. App. 13a. Casarottos agreed to open a shop at a less desirable location based upon a verbal agreement with Lombardi reserving for Casarottos the exclusive right to open a Subway shop in the preferred location when it became available. Pet. App. 13a. Contrary to that agreement, Lombardi and DAI subsequently awarded the preferred location to another franchisee. Pet. App. 13a. As a result, Casarottos' shop suffered irreparably and they lost their business and the collateral securing their SBA loan. Pet. App. 13a.

Casarottos brought an action in Montana district court in Great Falls to recover damages for tort and contract claims against DAI, Lombardi, and the other franchisee. Pet. App. 12a. The franchise agreement did not comply with the notice provisions of Montana's Uniform Arbitration Act.[2] Pet. App. 2a. The district court

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[2] Pertinent sections of that statute provide:

(2) A written agreement to submit to arbitration any controversy arising between the parties after the agreement is made is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract. . . .

* * *

(4) Notice that a contract is subject to arbitration pursuant to this chapter shall be typed in underlined capital letters on the first page of the contract; and unless such notice is displayed thereon, the contract may not be subject to arbitration. Mont. Code Ann. § 27-5-114 (1987).

held that the franchise agreement involved interstate commerce and stayed the lawsuit against DAI and Lombardi pending arbitration, pursuant to section 3 of the Federal Arbitration Act ("FAA") (9 U.S.C. § 3). Pet. App. 49a. Relying on this Court's analysis in *Volt Information Sciences v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), the Montana Supreme Court reversed. Pet. App. 2a. This Court granted certiorari, vacated the Montana Supreme Court's decision, and remanded for further consideration in light of its intervening decision, *Allied-Bruce Terminix Cos. v. Dobson*, 115 S.Ct. 834 (1995). *Doctor's Associates, Inc. v. Casarotto*, 115 S.Ct. 2552 (1995). After careful review of this case in light of *Terminix*, the Montana Supreme Court reaffirmed and reinstated its prior decision. Pet. App. 6a-7a. DAI and Lombardi have again petitioned for a writ of certiorari.

B. Initial Decision Below

Applying traditional conflict-of-law principles, the Montana Supreme Court held that Montana law governed the franchise agreement entered into between Casarotto and DAI. Pet. App. 15a-20a. The Montana court

determined that Montana had a materially greater interest than Connecticut in a contract negotiated in Montana, to be performed in Montana, regarding a sandwich shop in Montana, and entered into between a Montana resident and a Connecticut corporation (which has since merged with a Florida corporation, Pet. 4 n.1). Pet. App. 18a. The Montana court then found the contractual provision selecting Connecticut law was not effective because it violated Montana's fundamental public policy requiring disclosure of arbitration clauses, and Montana had a materially greater interest. Pet. App. 18a-20a.

Relying on this Court's analysis in *Volt* and standard implied preemption analysis, the Montana court found that Montana's notice provision is consistent with the goals and policies of the FAA and is therefore not preempted. Pet. App. 26a-27a. The FAA does not contain a preemptive provision or reflect congressional intent to occupy the entire field of arbitration. Pet. App. 24a. Therefore, state laws, like Montana's notice provision, which do not undermine the goals and policies of the FAA, are not preempted. Pet. App. 24a-25a. Because DAI's franchise agreement did not comply with Montana's statutory notice requirements, the agreement is not subject to arbitration according to Montana law. Pet. App. 27a.

DAI and Lombardi petitioned this Court for a writ of certiorari. Pet. App. 2a. This Court summarily vacated the Montana court's decision and remanded for further consideration in light of an intervening United States Supreme Court opinion, *Allied-Bruce Terminix Cos. v. Dobson. Doctor's Associates, Inc. v. Casarotto*, 115 S.Ct. 2552 (1995).

C. Decision on Remand.

After careful review,[3] the Montana Supreme Court concluded its earlier decision was consistent with *Terminix*. Pet. App. 7a. The central disputed issue in *Terminix* was whether the contract at issue involved interstate commerce. Pet. App. 6a. The Montana court presumed this case involved interstate commerce, and any state law which frustrated the purposes of the FAA would be preempted. Pet. App. at 6a. In *Terminix* this Court held the FAA preempted an anti-arbitration state law which flatly invalidated predispute arbitration clauses. Pet. App. 6a. The Montana court noted the challenged statute in this case does not make arbitration agreements unenforceable; it simply requires adequate notice of an arbitration clause in a contract. Pet. App. 6a. Finally, the Montana court noted that *Terminix* in no way modified *Volt*, the decision upon which the Montana court relied. Pet. App. 6a. Accordingly, the Montana court reaffirmed and reinstated its prior decision. Pet. App. 7a.

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[3] Petitioners complain that they were not given the opportunity to brief and argue the interpretation of this single case in front of the Montana court. Pet. App. 9. However, the Montana court allowed extensive briefing (one additional brief per side for a total of five briefs) when initially hearing this case. Neither the Federal Rules of Appellate Procedure nor the Montana Rules of Appellate Procedure make any provision for briefing or argument in cases remanded from this Court for further consideration. We note, however, that federal appellate courts routinely consider new authorities without briefing or argument. Indeed, Rule 28(j), Fed. R. App. P., requires that recently decided cases be presented to the court without argument.

REASONS FOR DENYING THE WRIT

The Petition should be denied because it does not raise issues that warrant review by this Court. The Montana Supreme Court's decision on remand is consistent with the principles enunciated in *Allied-Bruce Terminix Cos. v. Dobson*, 115 S.Ct. 834 (1995). The reaffirmed Montana Supreme Court decision was based on a permissible state court application of state rules of arbitration to a contract in which the parties agreed to abide by state law. This Court does not sit to review a *state court's* interpretation of state rules defining the parameters of arbitration when parties agree to apply state law in an arbitration agreement. *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468, 474 and 479 (1989); *accord, Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S.Ct. 1212, 1217 n.4 (1995) (distinguishing that a *federal* court's interpretation of contract is not entitled to such deference).

Contrary to Petitioners' protestations, the decisions below are consistent with this Court's holdings in both *Terminix*, 115 S.Ct. 834, and *Volt*, 489 U.S. 468. Further, the decisions below do not conflict with caselaw from the Circuits or that of other states. Since the Supreme Court's ruling in *Volt*, no Federal Circuit court or state court of last resort (except Montana) has addressed the applicability of the FAA to state law notice requirements when the parties agreed to apply state law. This question has not received the degree of judicial scrutiny which would warrant issuance of a writ of certiorari.

I. THE MONTANA SUPREME COURT PROPERLY APPLIED STATE RULES OF ARBITRATION, WHICH DO NOT UNDERMINE THE GOALS AND POLICIES OF THE FAA, TO A CONTRACT SELECTING STATE LAW.

The Montana court's decisions below are narrowly drawn to apply state law in a contract selecting state law, and are consistent with both *Terminix* and *Volt*. The parties to the arbitration agreement expressly agreed to apply state law. Pet. App. 15a. The Montana Supreme Court undertook a thorough conflict-of-law analysis, applying standard conflict-of-law principles in reaching its decision to apply Montana law.[4] Pet. App. 15a-20a. Petitioners do not present the Montana Supreme Court's application of Montana law and conflict-of-law analysis for review. They request review solely on the question of whether Section 2 of the FAA preempts Montana's notice requirement. Pet. (i).

The Montana Supreme Court relied on this Court's decision in *Volt* to find that the FAA did not preempt Montana's notice requirement. The Montana Supreme Court stated:

> Our conclusion that Montana's notice requirement does not undermine the policies of the

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[4] Similarly, in *Volt*, the California courts determined that the parties' choice of law provision incorporated California rules of arbitration. 489 U.S. at 472. The contracting parties in *Volt* specified, "[t]he contract shall be governed by the law of the place where the project is located." *Id.* at 470. As the contract was performed on the Stanford University campus, over appellants arguments, the California courts determined California law, including its rules of arbitration, applied. *Id.* at 470, 474.

> FAA is based on the Supreme Court's conclusion that its was never Congress's intent when it enacted the FAA to preempt the entire field of arbitration, and its further conclusion that the FAA does not require parties to arbitrate when they have not agreed to do so. The Court held that the purpose of the FAA is simply to enforce arbitration agreements into which parties had entered, and acknowledge that the interpretation of contracts is ordinarily a question of state law.

Pet. App. 16a, *citing Volt*, 489 U.S. at 474. Nothing in *Terminix* upset these cited principles. Pet. App. 6a.

Petitioners concede the primary issue in *Terminix*, construing the interstate commerce language of Section 2 of the FAA, is not at issue in this case. Pet. 13. In fact, the Montana court acknowledged this case involved interstate commerce and that any state law which frustrated the purposes of the FAA would be preempted. Pet. App. 6a.

Nor do the Montana decisions infringe upon the pro-arbitration policy enunciated in *Terminix* and *Volt*. While the preempted statute in *Terminix* invalidated all predispute arbitration clauses, the Montana statute specifically recognizes the enforceability of such arbitration agreements; it merely requires notice of an arbitration clause in a contract, to allow parties to be adequately informed. Pet. App. 6a. The Montana court presumed that this state requirement would not be a threat to the policies of the FAA. Pet. App. 4a. To hold otherwise would run contrary to the conclusion that contracting parties are free to determine how their disputes will be resolved. Pet. App. 4a. Further, such a holding would suggest that arbitration

was so onerous that it could only be thrust upon the uninformed. Pet. App. 4a.

The Montana Supreme Court decisions were based on a permissible state court application of standard conflict-of-law principles and carefully calibrated state rules of arbitration to a contract in which the parties agreed to abide by state law. This Court has indicated that it will not set aside a state court's interpretation of the laws of the state where the contract is to be performed. *Volt*, 489 U.S. at 474; *accord*, *Mastrobuono*, 115 S.Ct. at 1217 n.4. Thus, this Court should not sit to review the matters of state law addressed by the Montana Supreme Court in this case.

II. THE DECISION OF THE MONTANA SUPREME COURT IS IN CONCERT WITH EXISTING CASE-LAW.

In attempting to demonstrate a conflict requiring resolution by this Court, Petitioners mischaracterize the holdings of the Montana Supreme Court and other cited decisions. In fact, the authorities which Petitioners rely on are readily distinguished from the instant proceedings because they i) do not include the preemption analysis in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), or ii) do not involve contractual provisions which select state law. The Montana court correctly recognized these cases are not persuasive. Pet. App. 26a. The authority relied on by DAI is inapposite.

DAI's attempt to portray a conflict based on pre-*Volt* cases, which have lost their authority in light of *Volt*,

should fail. Two cited cases which purportedly conflict with the decisions below were decided before *Volt*: *Webb v. R. Rowland & Co.*, 800 F.2d 803 (8th Cir. 1986) and *Bunge Corp. v. Perryville Feed & Produce, Inc.*, 685 S.W.2d 837 (Mo. 1985). In *Webb* the Eighth Circuit applied a pre-*Volt* analysis to a contract which invoked Missouri law. 800 F.2d at 806. *Volt* clarifies that when the parties have agreed to be bound by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA. Pet. App. 14a. Applying this Court's preemption analysis as articulated in *Volt*, the Eighth Circuit should reach a different decision regarding the Missouri statute.

Similarly, in *Bunge Corp.*, a decision four years before *Volt*, the Missouri Supreme Court found a contractual dispute subject to the rules and regulations of the National Grain and Feed Association was subject to arbitration. 685 S.W.2d at 838. Like the Montana court, the Missouri court acknowledged that Missouri's statutory notice requirements could not be applied to undermine the FAA. *Id.* at 839. However, the Missouri court refrained from invalidating Missouri's statute, stating, "[w]e do not have to decide, and we do not decide, whether an arbitration agreement *governed by Missouri law* is unenforceable in all events. . . . " *Id.* at 839 (emphasis supplied). Thus the Missouri court sidestepped the decision addressed squarely by the Montana Supreme Court in this case. Despite Petitioners' arguments, there is no conflict in these decisions.

Furthermore, the decisions of the Montana Supreme Court addressed a distinct issue from Petitioners' post-*Volt* authority in which the parties did not invoke

state law. In *David L. Threlkeld & Co. v. Metallgesellschaft Ltd. (London)*, 923 F.2d 245, 247 and 250 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991), the parties agreed to arbitration in accordance with the rules and regulations of the London Metals Exchange. Accordingly, the Second Circuit applied the international convention (9 U.S.C. § 202), a discrete section of the FAA.[5] Similarly, where parties agreed to be bound by the rules of Federal Arbitration Act, rather than the law of any state, the federal district court in Montana appropriately applied those rules. *Snap-On Tools Corp. v. Vetter*, 838 F. Supp. 468 (D. Mont. 1993). These decisions, enforcing contracts according to those rules by which the parties agreed to be bound, are in accord with the Montana Supreme Court decisions in the instant case.

Another cited case, *Securities Industry Ass'n v. Connolly*, 883 F.2d 1114 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990), simply did not address the parties' ability to invoke state law. In that case, the First Circuit held that the FAA preempted Massachusetts regulations concerning predispute arbitration agreements for securities brokers. Unlike the present case, no consideration was given to the ability of the parties to invoke state law through a

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[5] Unlike the current case, the decision in *Threlkeld* involved international commerce, an area in which the policy favoring arbitration is "even stronger" and "applies with special force." *Threlkeld*, 923 F.2d 248, *citing Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985). Additionally, *Threlkeld* applied Section 202 of the FAA, 9 U.S.C. § 202, rather than Section 2, at issue in this case.

choice-of-law provision. Thus *Connolly* addresses a distinct issue from that presented in this case where franchisor invoked state law by the terms of its own franchise agreement.

The Montana decisions are squarely consistent with *Volt*, and the principles enunciated in *Terminix*. The decisions below are distinguishable from the cases cited by Petitioners. They do not directly conflict with any decision of this Court, nor of any federal court of appeals. There is no split in the circuits nor an intolerable conflict between the decisions of the highest state courts.

Moreover, and without conceding the point, even if one were inclined towards the view that the Montana Supreme Court's decision conflicts with rulings by other courts, the "conflict" Petitioners allege is plainly tolerable at this time. Try as Petitioners might, they could only identify three post-*Volt* cases, in addition to this case, from state supreme courts or federal appellate courts in which the validity of state notice requirements has been litigated. This proceeding is the only one in which the parties selected state law. Significantly, there is no conflict between the decision below and any ruling of the Ninth Circuit, such that a different result would be mandated depending upon whether a case is filed in state court or federal court.[6] *Compare American Airlines, Inc. v. Wolens,*

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[6] In a footnote, petitioners cite *Snap-On Tools Corp. v. Vetter*, 838 F. Supp. 468 (D. Mont. 1993), as a case where the Montana notice statute was preempted by the FAA, but that case is distinguishable, as the parties there agreed to be governed by federal law, such that the Montana notice law could not take precedence. *Id.* at 472.

115 S.Ct. 817 (1995), and *Edenfield v. Fane*, 113 S.Ct. 1792 (1993) (granting review in cases where state and federal appellate courts reached opposite conclusions).

If anything, the weakness in Petitioners' line of attack is illustrated by their reliance, at least in part, on dire predictions about what state legislatures and other courts might do if this lone decision from the Montana Supreme Court is allowed to stand (Pet. App. 22-25), a tacit concession that the legal issue they raise has not yet matured to the point that review by this Court is appropriate at this time. Thus, when all is said and done, Petitioners' real quarrel with the decision below is the fact that they lost. That is not sufficient reason for this Court to grant review.

III. THE MONTANA SUPREME COURT DECISION IS NOT A GOOD VEHICLE FOR ADDRESSING THE CONCERNS RAISED BY PETITIONERS.

The Petitioners attempt to portray the Montana decision as one of national importance. Pet. 22-25. However, Montana is the only state to hold that the state notice provision is applicable when parties select state law in their contract, and no federal circuit court has ruled on this particular issue after *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989). Should the states rise and follow Montana's lead regarding the preemptive scope of the FAA, as Petitioners predict (Pet. at 25), actual conflicts may appear and the issue will then be more appropriate for this Court's review. One of those future cases may provide a more straightforward vehicle, without the need for

this Court to engage in a conflict-of-law analysis or to decide whether the acts of the franchisor's development agent are subject to arbitration under the franchise agreement.

Nor, unlike the situation this Court confronted in *Terminix*, is this case part of a larger pattern of hostility toward arbitration on the part of a state legislature and supreme court.[7] To the contrary, the statute at issue in this case has served as the basis for vigorous enforcement of arbitration agreements in Montana.[8] As Petitioners readily conceded below, the Montana Supreme Court,

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[7] After *Allied-Bruce Terminix Companies, Inc. v. Dobson*, 115 S.Ct. 834 (1995), this Court also vacated three other Alabama Supreme Court decisions that refused to give effect to arbitration provisions: *Home Buyers Warranty Corp. II v. Lopez*, 115 S.Ct. 930 (1995); *Terminix Int'l, Ltd. P'ship v. Jackson*, 115 S.Ct. 930 (1995); and *So. Health Corp. of Hamilton, Inc. v. Lorance*, 115 S.Ct. 930 (1995).

[8] *See, e.g., Chor v. Piper, Jaffray & Hopwood, Inc.*, 862 P.2d 26 (Mont. 1993) (finding contracts requiring arbitration are as enforceable in Montana as any other contracts); *Downey v. Christensen*, 825 P.2d 557 (Mont. 1992) (holding franchisor's participation in discovery did not waive right to compel arbitration); *Vukasin v. D.A. Davidson & Co.*, 785 P.2d 713 (Mont. 1990) (finding arbitration clause in annual review document an enforceable part of employment agreement); *Gibson v. James Graff Communications, Inc.*, 780 P.2d 1131 (Mont. 1989) (finding contract involving interstate commerce subject to the FAA); *Larsen v. Opie*, 771 P.2d 977 (Mont. 1989) (holding claim of fraud in the inducement of the execution of a contract containing an arbitration clause is to be decided by arbitration); *Passage v. Prudential-Bache Securities*, 727 P.2d 1298 (Mont. 1986), *cert. denied*, 480 U.S. 905 (1987) (holding parties subject to arbitration even if customer agreement at issue was found to be a contract of adhesion).

"has consistently upheld the federal policy in favor of arbitration and applied the FAA to arbitration clauses in contracts involving interstate commerce." Brief for the Appellees Nick Lombardi and Doctor's Associates, Inc., at 9, *Casarotto v. Lombardi*, 886 P.2d 931 (Mont. 1994). In light of their own concessions below, Petitioners' assertions of Montana's hostility toward arbitration (Pet. 14-15) ring hollow.

This Court has consistently held that the FAA only places arbitration agreements on the same footing as other contracts, but does not make super contracts out of such agreements.[9] Petitioner DAI routinely drafts the contracts in question. It certainly remains within its power to control the forum for resolving disputes by deciding whether to include a choice-of-law provision selecting or barring the application of state law and its concomitant rules of arbitration.

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[9] *Allied-Bruce Terminix Companies, Inc.*, 115 S.Ct. at 840; *Volt*, 489 U.S. at 474-75 (stating the FAA does not give parties powers in excess of any other contract clause); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985) (recognizing a party may exclude certain claims from the scope of their arbitration agreement); *Moses H. Cone Memorial Hosp. v. Mercury Constr. Co.*, 460 U.S. 1 (1983) (finding the FAA puts arbitration clauses on the same footing as other contracts and reflecting a general federal policy favoring arbitration); *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967) (holding the Federal Arbitration Act makes arbitration agreements "as enforceable as other contracts, but not more so").

CONCLUSION

For the reasons set forth above, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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